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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1965.

EUCLID-TENNESSEE, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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IN THE

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vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Euclid-Tennessee, Inc., a Tennessee corporation, petitions for a writ of certiorari to review the judgment of the Court of Appeals for the Sixth Circuit in this case (No. 15,993 below).

OPINION BELOW

The opinion of the Court of Appeals (*infra*, A1) is reported at 352 F.2d 991. The findings of fact and opinion of the Tax Court are reported at 41 T.C. 752 (1964). The opinion of the Tax Court is included in the appendix hereto (A8).

JURISDICTION

The judgment of the Court of Appeals was entered on December 2, 1965. (Certified record). The jurisdiction of this Court is invoked under 28 U.S.C., Sec. 1254(1).

QUESTION PRESENTED

By enacting Section 382(a)(1) of the Internal Revenue Code (1954), did Congress destroy the precedential value of *Libson Shops* v. *Koehler*, 353 U.S. 382, or do the "broad principles" of *Libson Shops* continue to be "relevant" to the extent that a taxpayer corporation may be denied the right to use loss carry-overs to offset gains of a business unrelated to that which produced the losses, in spite of the fact that, in literal compliance with the statutory condition, it "continued to carry on a trade or business substantially the same as that conducted before any change in the percentage ownership of the fair market value of" its stock?

STATUTE INVOLVED

"SEC. 382. SPECIAL LIMITATIONS ON NET OPERATING LOSS CARRYOVERS.

"(a) Purchase of a Corporation and Change in Its Trade or Business.—

"(1) In General.—If, at the end of a taxable year of a corporation—

"(A) any one or more of those persons described in paragraph (2) own a percentage of the total fair market value of the outstand-

ing stock of such corporation which is at least 50 percentage points more than such person or persons owned at—

"(i) the beginning of such taxable year, or

"(ii) the beginning of the prior taxable year,

"(B) the increase in percentage points at the end of such taxable year is attributable to—

"(i) a purchase by such person or persons of such stock, the stock of another corporation owning stock in such corporation, or an interest in a partnership or trust owning stock in such corporation, or

"(ii) a decrease in the amount of such stock outstanding or the amount of stock outstanding of another corporation owning stock in such corporation, except a decrease resulting from a redemption to pay death taxes to which section 303 applies, and

"(C) such corporation has not continued to carry on a trade or business substantially the same as that conducted before any change in the percentage ownership of the fair market value of such stock,

the net operating loss carryovers, if any, from prior taxable years of such corporation to such taxable year and subsequent taxable years shall not be included in the net operating loss deduction for such taxable year and subsequent taxable years."

* * *

STATEMENT

The crucial facts on the issue involved in this appeal were stipulated, and are set forth below, together with additional undisputed facts shown in the evidence and found by the Tax Court.

Euclid-Tennessee, Inc., the petitioner, was incorporated on July 21, 1931, as The William Gerst Brewing Company, Incorporated, with charter authority to manufacture and sell soft drinks, including near beer. (8a).[1] After engaging in the business of manufacturing and distributing real beer, it "abandoned its brewery operations on July 1, 1954," due to union trouble and an unsatisfactory market, and "sold its brewery equipment." During the operation of the brewery, petitioner incurred losses of $42,092.37 in 1952, $117,209.88 in 1953 and $142,767.23 in 1954. (5a-6a).

Petitioner had retained its real estate, consisting of approximately 200,000 square feet of land and buildings located thereon, in the City of Nashville, Tennessee, and after July 1, 1954, "operated solely as a real estate owning and leasing corporation. The real property . . . was always for sale and there was no intention of engaging permanently in this owning and leasing business if the property could be sold advantageously." . . . "In 1955 and 1956, it incurred losses of $6,023.44 and $5,112.50, respectively, from its operation as a real estate owner and leasing corporation." (6a).

A corporation with the name of Euclid-Tennessee, Inc. (hereinafter referred to as "Euclid"), was incorporated on

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1. References are to the Court of Appeals appendix. Where quotation marks are used, the quotation is from the stipulation.

November 26, 1954. (As will be shown, this is not the same corporation as the petitioner.) It was engaged in the business of selling and servicing construction machinery and equipment, and occupied leased premises at 720 Murfreesboro Road, Nashville, Tennessee. Due to the imminent construction of an interstate highway with appurtenant cloverleaf access roads, which required the taking of a portion of the property occupied by Euclid and would have rendered the remainder of such property unsuitable, had not the owner been able at a later date to purchase additional land, Euclid began to look for a new location to which it could move its business. Through its bankers, it learned that the petitioner's property might be available. (17a).

On March 12, 1957, Euclid, through an agent, offered to purchase all the outstanding stock of petitioner from its stockholders for $75,000.00 cash, upon the condition that the selling stockholders would discharge all current liabilities of petitioner, such offer to remain in effect 10 days. The real estate was encumbered by long term mortgage indebtedness of approximately $190,000.00 which was to remain in effect. The amount offered was based upon appraisals of the land and buildings and upon a comparison of prices paid for nearby property. One of the provisions of the offer was that petitioner's name be changed to either Sixth Avenue Properties, Inc., or South Nashville Properties, Inc. The latter change of name had previously been authorized by petitioner's Board of Directors, on October 3, 1956. This offer was accepted on or about March 15, 1957, and on April 2, 1957, petitioner's charter was amended to change its name to South Nashville Properties, Inc. (6a-7a, 11a, 17a).

A new corporation, Trippeer Industrials Corporation (hereinafter referred to as "Trippeer"), was organized on

April 8, 1957, for the purpose of purchasing petitioner's capital stock. The subscribers to Trippeer's capital stock were the same persons who owned all the outstanding stock of Euclid and their subscriptions were paid in Euclid stock. As a result, the former stockholders of Euclid received the stock of Trippeer in exchange for their Euclid stock. (18a).

On April 10, 1957, Trippeer consummated the purchase of the stock of petitioner and thereupon owned all the outstanding capital stock of it and Euclid. Thereafter, on April 22, 1957, Trippeer donated to petitioner all the capital stock of Euclid and on May 2, 1957, Euclid was merged into petitioner and the petitioner then changed its name to Euclid-Tennessee, Inc. The charter amendment of May 2, 1957, also expanded the corporate purposes in the charter to include the business of selling and servicing construction equipment, as well as to deal in and dispose of real estate, real property and any interest or right therein. (18a-19a).

Subsequent to the change in stock ownership which occurred on April 22, 1957, petitioner continued to engage in the business of owning and leasing real estate, which had been its sole business since July 1, 1954. (6a, 12a-13a, 16a). Petitioner also carried on the construction equipment business formerly engaged in by Euclid. In connection with its real estate business, petitioner purchased an additional parcel of land on 6th Avenue, South, across the street from the old brewery property and tried unsuccessfully to purchase another block of land adjacent to the property. The leased buildings were remodeled and one new building was constructed. The tenants included former tenants and also, as new tenants, corporations affiliated with petitioner engaged in the steel fabricating business and the material handling business. (12a-14a, 20a).

During the taxable year 1957, petitioner had rental income in the amount of $26,572.45; in 1958, in the amount

of $21,099.96; and in the 9-month period ending September 30, 1959, in the amount of $13,360.39. During the same taxable years and period, petitioner's gross sales from the construction equipment business were $1,941,214.29, $2,-922,333.61 and $3,663,850.62, respectively. (20a).

On its tax returns for the taxable years 1957, 1958 and the 9-month period ending September 30, 1959, petitioner reported net operating loss carryovers of $133,943.77, $99,072.91 and $115,114.69, respectively. Respondent disallowed these deductions in his notice of deficiency stating that "petitioner failed to establish that the deduction is allowable." (20a).

The Tax Court held that petitioner did not, within Section 382(a) of the Internal Revenue Code of 1962, "continue to carry on substantially the same trade or business after the acquisition of its stock by Trippeer," because it did not resume the manufacture and distribution of beer, from which most of the losses had come.

Following entry of decision in favor of the Commissioner, petitioner duly filed its petition for review. The Court of Appeals affirmed, holding "relevant" the "broad principles" of *Libson Shops*, and invoking "Congressional purpose" to prevent "the purchase of the stock of a corporation with a history of losses for the purpose of using its loss carryovers to offset gains of a business unrelated to that which produced the losses."

REASONS FOR GRANTING WRIT

On October 13, 1965, the Internal Revenue Service issued Technical Information Release 773 (34 L. W. 2207), from which we quote:

> "In *Maxwell Hardware Co.* v. *U. S.*, 343 F.2d 713, the Ninth Circuit held that *Libson Shops, Inc.* v. *Koeh-*

ler, 353 U.S. 382, has no precedential value under the 1954 Code and that the net operating loss carryovers in that case were not subject to disallowance under Sections 172, 269, or 382.

"Despite the opinion of the Ninth Circuit, the foregoing statutory provisions must be construed to effectuate congressional intent in combatting 'trafficking in loss carryovers.' Moreover, the loss carryover in cases similar to *Maxwell Hardware* should be denied under the rationale of *Libson* since, to permit a loss carryover in such cases, would run counter to the legislative objectives of the carryover privilege. The fundamental type of statutory analysis utilized by the Supreme Court in *Libson* was not made obsolete by the enactment in 1954 of provisions limiting or denying loss carryovers in certain situations involving abuses that were specifically brought to the attention of Congress. The basic approach of *Libson* retained vitality under the 1954 Code in interpreting the application of Section 172.

* * *

"Certiorari was not requested in *Maxwell Hardware* due to the absence of a direct conflict between the circuits. The decision, however, will not be followed as a precedent in the disposition of similar cases."

The present case presents the conflict between circuits which was previously absent. The Court of Appeals in the instant case, without citing *Maxwell Hardware,* rejected the view of the Ninth Circuit Court of Appeals that Congress, by enacting Section 382(a)(1) of the 1954 Code, destroyed the precedential value of *Libson Shops.* The Sixth Circuit has adopted the approach of T.I.R. 773, but without citing it.

The Court in the instant case also rejected the reasoning of *Glover Packing Company of Texas* v. *United States,* 328 F.2d 342 (Ct. Cl. 1964), but again without citing

the case. There the factual situation was the converse of the one here presented, and the decision was for the government. The taxpayer corporation incurred losses in the meat packing business; it abandoned that business and leased its real estate for four or five years while trying to find a buyer; there was then a change of stock ownership, after which the corporation resumed the meat packing business and made profits; but the corporation discontinued the leasing of its real estate. The Court of Claims held that the prior losses could not be used to offset these profits, saying: "Plaintiff's sole business during the period of four or five years prior to Glover's acquisition was the leasing of its building."

The Court of Claims in *Glover* said (p. 349) that in enacting Section 382(a), Congress "created a mechanical standard for determining the circumstances in which the loss carryover would be unavailable. . . ." We contend that this is clearly the correct view. The mechanical standard is whether *a* business conducted before the change in stock ownership is *continued*. In *Glover*, the carryover was disallowed because the real estate business was not continued. In the instant case, the real estate business *was* continued. This may be an artificial distinction, but it is the distinction which the statute makes. It is not the province of the courts, under the guise of interpretation, "to do what the legislative branch of the Government failed to do or elected not to do." *Hanover Bank* v. *Commissioner*, 369 U.S. 672, 588.

CONCLUSION

For the foregoing reasons this petition for certiorari should be granted.

Respectfully submitted,

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No. 15993

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

EUCLID-TENNESSEE, INC., *Petitioner,*
v.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

ON PETITION FOR REVIEW of Decision of the Tax Court of the United States.

Decided December 2, 1965.

Before O'SULLIVAN, Circuit Judge, and CECIL and McALLISTER, Senior Circuit Judges.

O'SULLIVAN, Circuit Judge. By its petition Euclid-Tennessee, Inc., seeks reversal of a Tax Court determination that Section 382(a)(1), of the Internal Revenue Code of 1954,[1] 26 U.S.C.A. 382(a)(1), prohibited its carry-

1. § 382. Special limitations on net operating loss carryovers

(a) Purchase of a corporation and change in its trade or business.—

(1) In general.—If, at the end of a taxable year of a corporation—

(A) any one or more of those persons described in paragraph (2) own a percentage of the total fair market value of the outstanding stock of such corporation which

(Footnote 1 continued on page A2)

over of losses sustained in the brewing business to offset profits later made in the heavy equipment business after a complete change in the ownership of the taxpayer corporation. The opinion of the Tax Court is reported as *Euclid-Tennessee, Inc.*, v. *Commissioner*, 41 T.C. 752 (1964).

1. The facts.

The record in the Tax Court was for the most part made from stipulated facts, supplemented by oral testimony which presented substantially no factual issues other than the ultimate factual inference drawn by the Tax Court. To the extent that its decision rests thereon, we must accept the Tax Court's final inference of fact unless we find it

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(Footnote 1 continued from page A1)

is at least 50 percentage points more than such person or persons owned at—

(i) the beginning of such taxable year, or

(ii) the beginning of the prior taxable year,

(B) the increase in percentage points at the end of such taxable year is attributable to—

(i) a purchase by such person or persons of such stock, the stock of another corporation owning stock in such corporation, or an interest in a partnership or trust owning stock in such corporation, or

(ii) a decrease in the amount of such stock outstanding or the amount of stock outstanding of another corporation owning stock in such corporation, except a decrease resulting from a redemption to pay death taxes to which section 303 applies, and

(C) *such corporation has not continued to carry on a trade or business substantially the same as that conducted before any change in the percentage ownership of the fair market value of such stock* (emphasis supplied), the net operating loss carryovers, if any, from prior taxable years of such corporation to such taxable year and subsequent taxable years shall not be included in the net operating loss deduction for such taxable year and subsequent taxable years.

clearly erroneous. *Duberstein* v. *Commissioner*, 363 U.S. 178 (1960). Being of the opinion that the Tax Court was not wrong in its construction of the applicable statute, nor clearly erroneous in its finding of facts, we affirm.

The Tax Court opinion details facts. We repeat some of them to the extent necessary to expose our reasons for sustaining the Tax Court. From 1931 until 1954, the taxpayer, originally named the William Gerst Brewing Company, carried on the brewery business in Nashville, Tennessee. In 1954, after several years of heavy losses, it abandoned such enterprise. In that year it sold all of the equipment theretofore used in the brewery business but continued the corporate life of the brewery for the purpose of liquidating its real estate. In 1957 there was a corporation named Euclid-Tennessee, Inc. profitably engaged in the business of selling and servicing construction equipment. Its plant was also in Nashville. This company, herein sometimes called Old Euclid, became aware of the net operating losses then available to the Gerst Brewing Company as carryover tax deductions from profits. Old Euclid's awareness of this situation coincided with its knowledge in 1957 that a highway development might take some of its plant site and require the relocating of it. This need was asserted as at least part of the motivation for acquiring the property of the abandoned brewery.[2] The

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2. While such need for a new plant site was relied upon as Old Euclid's motivation for taking over the brewery, there was evidence from one of its principal officers that in late 1956 he had made a trip to New York to attend a conference concerning loss carryovers. There was also evidence that in March, 1957, the month in which the corporate maneuvers here involved commenced, a change in the highway project obviated any need for moving Old Euclid's plant. In all events, Old Euclid did not move its plant and the taxpayer which is an extension of the corporate entity which was once a brewery operates out of such plant.

brewery corporation in the two and one-half years following the closing of the brewery rented its real estate but continued to suffer losses. It was stipulated that this real estate "was always for sale and there was no intention of engaging in this owning and leasing business if the property could be sold advantageously."

In March, 1957, Old Euclid, through an agent, offered to buy the corporate shares of Gerst Brewing. A condition of the offer was that Gerst Brewery would first change its corporate name either to Sixth Avenue Properties or South Nashville Properties, Inc. The offer was accepted by Gerst Brewing shareholders, but the purchase was not consummated by Old Euclid. Instead a new holding corporation, Trippeer Industrials Corp., was organized by Old Euclid shareholders. Their stock subscriptions to Trippeer were paid for by exchanging all of the stock of Old Euclid for all of the stock of Trippeer. Trippeer then accepted the offer that the Gerst Brewing shareholders had made to Old Euclid's agent and acquired such stock. Gerst Brewing had fulfilled the condition of the offer of purchase by changing its name to South Nashville Properties, Inc.[3] When this step was accomplished, Trippeer for an interval owned two subsidiaries—Old Euclid, (the profitable machinery business) and South Nashville Properties, Inc. (the old brewery).

As a next step Trippeer donated all the stock of Old Euclid to South Nashville Properties, Inc. This was followed by corporate action which merged Old Euclid into South Nashville Properties, Inc. Thus the latter company

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3. This change of name had the obvious purpose of giving to the old brewery company the appearance of a company already operating in the business of holding and leasing real estate. It should be mentioned that Gerst Brewery's recorded corporate purpose had never encompassed such an activity, although Tennessee law permitted all corporations to hold and lease real estate.

became the owner of the profitable machinery business of Old Euclid and continued to own the remnant assets of the former brewery. The former shareholders of Old Euclid now owned a corporation with a past experience of substantial net operating losses which, if permitted by the Internal Revenue Code, could be carried over as deductions from the profits to be earned in the machinery business. To round out the program, South Nashville Properties, Inc. changed its name to Euclid Tennessee, Inc., and its corporate address to 720 Murfreesboro Road (Old Euclid's unchanged plant site) and changed the purposes clause in its charter to the clause which had been in the charter of Old Euclid; the charter purpose was also expanded to permit dealing in real estate. All of this was accomplished in the months of March and April, 1957. Thereafter the taxpayer attempted to carry over the losses suffered in the brewery business and deduct them from the substantial profits of the machinery business.[4] The Commissioner of Internal Revenue resisted and thus we have this lawsuit.

The primary purposes (and results) of the transactions just described may be summarized as follows: The

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4. The advantages of this total enterprise if successful is illustrated by comparing the post-merger relationship of gross rentals from the old brewery property to the gross sales in the machinery business in the tax years here involved. In 1957 gross sales were $1,941,214.19 and gross property rentals were $26,572.45; in 1958 they were $2,722,333.61 and $21,099.96, respectively; and in the first nine months of 1959, $3,663,850.62 and $13,360.39. This review demonstrates the insignificance of the proceeds of the use of the brewery property (in part by taxpayer's affiliates engaged in allied activities) to petitioners overall operations—rental income was 0.71 percent of total sales and the remaining 99.29 percent from the machinery and heavy equipment business. In the years in question, taxpayer reported net operating loss carryovers of $133,943.77, $99,072.91 and $115,-114.69, respectively.

brewery's former shareholders disposed of its remaining assets by selling their stock. Shareholders of the purchaser then determined, by using a short lived holding company, to pluck their successful machinery business from its former shell and, by donation and merger, shoe-horn it into the corporate entity of the defunct brewery. Aside from possible loss carryovers, the result was precisely the same as would have been accomplished by an outright purchase of the real estate of the inoperative brewery. However, there was nothing illegal or immoral in the circuity of the maneuvers employed. The question is whether what they accomplished met the requirements of § 382(a)(1)(C), thus to permit enjoyment of the tax advantage claimed.

2. The rule to be applied.

Conditions justifying the Commissioner's disallowance of the deductions here involved are present if the Tax Court's decision can be fairly read as a finding that "such corporation [the taxpayer] has not [following the merger] continued to carry on *a* trade or business substantially the same as that conducted before any change * * *." (§ 382(a)(D)(C)), and if such finding was warranted by the evidence. The Tax Court opinion includes what it terms its Ultimate Finding as follows:

> "Petitioner did not continue to carry on substantially *the* same trade or business after the acquisition of its stock by Trippeer."

We believe that the Tax Court's substitution of "the" in its Ultimate Finding for the "a" of the statute could, standing alone, be an impermissible extension of the conditions which must be satisfied to allow use of net operating losses as carryover deductions. Such substitution might indeed require that, after the change of ownership, a corpo-

ration's overall operations must be such as to be in total "substantially *the* same trade or business" as theretofore carried on. This requirement would be more severe than the judicial rule developed under the 1939 Code and the Treasury Regulations under the present 1954 Code.[5] But notwithstanding the language of its ultimate finding, we read the entirety of the Tax Court's opinion as a finding that the post-merger renting and holding of what was the old brewery real estate as an insignificant incident to taxpayer's whole purpose was not the carrying on of "a trade or business substantially the same as that conducted [by the brewery] before [the merger]", i.e. holding and renting its remnant assets awaiting complete liquidation of what was the Gerst Brewing Company. Were we to indulge the view that Gerst Brewing Company's holding and renting of its remnant assets constituted "*a* trade or business," we do not find error in the Tax Court's view that the taxpayer machinery company's use of such assets was not "a trade or business" having any existence as an enterprise "substantially the same as that conducted" by the defunct brewery in winding up its affairs.

We have recently had occasion to review decisions denying the use of premerger losses in one line of endeavor to offset postmerger profits from a different enterprise under the 1939 Code. *Fawick Corp.* v. *Commissioner,* 342 F(2) 823 (CA 6, 1965). We there discussed *Libson Shops, Inc.* v. *Koehler,* 353 U.S. 382, 1 L.Ed.(2) 924 and the cases that followed it. We cannot and do not read *Libson* into the 1954 Code, but its broad principles may be relevant except as the 1954 Code, under limited conditions, permits what the 1939 Code, construed by *Libson,* forbade. The Congressional purpose in enacting the statute here involved

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5. See Treas. Reg. § 1.382(a)—1(b)(8). *Cf. Commissioner* v. *Goodman Crockery Co.,* 315 F(2) 110, 112 (CA 6, 1963).

was to prevent "the purchase of the stock of a corporation with a history of losses for the purpose of using its loss carryovers to offset gains of a business unrelated to that which produced the losses." S. Rep. No. 1622, 83d Cong., 2d Sess., p. 53, 3 U.S.C. Cong. & Adm. News 4621, 4684 (1954). See also Treas. Reg. § 1.382 (a)—1(b)(5) (1962). We think that such Congressional purpose was served and that its strict language is not violated by the Tax Court's decision.

We affirm the judgment of the Tax Court.

41 T. C. No. 74

TAX COURT OF THE UNITED STATES

EUCLID-TENNESSEE, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 91228. Filed March 6, 1964.

(Findings of Fact Omitted)

Ultimate Finding.

Petitioner did not continue to carry on substantially the same trade or business after the acquisition of its stock by Trippeer.

Opinion.

The threshold controversy in this case centers around the narrow question of whether the petitioner "continued to carry on a trade or business substantially the same as that conducted before" its stock was purchased by Trippeer.

The applicable provision of the law is section 382(a),[1] Internal Revenue Code of 1954, which imposes special limitations on the use of net operating loss carryovers following certain changes in stock ownership resulting from stock purchase.

There is no dispute about the existence of the requisite percentage change in stock ownership or that a "purchase" of the petitioner's stock was made by the "persons" described in section 382(a)(2). The only limitation which is in dispute is that imposed by section 382(a)(1)(C).[2]

Petitioner contends that it was engaged exclusively in the "business" of owning and leasing real estate for 2-1/2 years after the termination of its brewery operations on July 1, 1954. The petitioner admits that after the change in its stock ownership it also engaged in the business of selling and servicing construction equipment, but asserts that adding "an additional line of business does not mean that it failed to continue to carry on a trade or business substantially the same as that conducted before the change in ownership." To support its contention the petitioner cites our decision in *Goodwyn Crockery Co.*, 37 T.C. 355 (1961), affd. 315 F.2d 110 (C.A. 6, 1963). Taking the contrary view, respondent argues that the "business" of the loss corporation was "substantially changed" and that the

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1. (Omitted.)

2. Respondent states in his reply brief that he is not relying here on the doctrine of *Libson Shops, Inc.*, v. *Koehler*, 353 U.S. 382 (1957). This is in accord with the position asserted by the petitioner in its original brief. Cf. *Arthur T. Beckett*, 41 T.C. 386 (1963), where we said at page 416 that "it might be that where the change in ownership provision of sec. 382(a)(1)(C) applied, the principle of the *Libson Shops, Inc.*, case would be inapplicable since the statute now specifically provides the extent to which the net operating loss shall be disallowed under such circumstances."

general intent of Congress in enacting section 382 was to prohibit the use of loss carryovers to offset profits of a business unrelated to that which caused the loss.

We agree with petitioner that adding a new business does not necessarily trigger the change-of-business test so long as the "prior business" is continued.[3] But just what was the prior business of Gerst? Was it the manufacture and distribution of beer? Or was it merely the temporary rental of its industrial buildings following the abandonment of its brewery operations? In our opinion the correct answer—and certainly the realistic one under these facts and circumstances—is that the "prior business" was the manufacture and distribution of beer and not the leasing of its real property.

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3. Sec. 1.382(a)-1(h)(8) [Income Tax Regs.]. If, after an increase in ownership, the corporation continues to carry on its prior business activities substantially undiminished, the addition by the corporation of a new trade or business does not constitute a failure to carry on substantially the same trade or business. This subparagraph may be illustrated by the following example:

> Example. X Corporation, a calendar-year taxpayer, is engaged in the manufacture and sale of electrical appliances and has sustained substantial net operating losses. On June 30, 1958, Y Corporation purchases 100 percent of X Corporation's outstanding stock. During 1959, X Corporation continues substantially undiminished its activities in the manufacture and sale of electrical appliances and also diversifies its activities by acquiring a cement manufacturing plant. The addition of the cement manufacturing business by X Corporation does not of itself constitute a failure to carry on substantially the same trade or business even though net operating loss carryovers attributable to the electrical appliance business are used to offset profits of the cement manufacturing business. See, however, section 269 and the regulations thereunder.

Both the regulations[4] and the Senate Committee Report[5] clearly indicate that the very transaction section

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4. Sec. 1.382(a)-1(h)(5) [Income Tax Regs.]. In determining whether a corporation has not continued to carry on a trade or business substantially the same as that conducted before any increase in the ownership of its stock, all the facts and circumstances of the particular case shall be taken into account. Among the relevant factors to be taken into account are changes in the corporation's employees, plant, equipment, product, location, customers and other items which are significant in determining whether there is, or is not, a continuity of the same business enterprise. These factors shall be evaluated in the light of the general objective of section 382(a) to disallow net operating loss carryovers where there is a purchase of the stock of a corporation and its loss carryovers are used to offset gains of a business unrelated to that which produced the losses. However the prohibited utilization of net operating loss carryovers to offset gains of a business unrelated to that which produced the losses is not dependent upon considerations of purpose, motive, or intent, but rather is established by the objective facts of the particular case. The principles set forth in this subparagraph shall be applied in accordance with the rules set forth in the following subparagraphs of this paragraph.

5. S. Rept. No. 1622, to accompany H.R. 8300 (P.L. 591), 83d Cong., 2d Sess. (1954), reads in part as follows:

> Under present law where a controlling interest in a corporation is acquired for the purpose of avoiding or evading tax liabilities the Internal Revenue Service may disallow the benefits of a deduction, credit, or allowance which would otherwise be enjoyed by the acquiring person or corporation. This provision has proved ineffectual, however, because of the necessity of proving that tax avoidance was the primary purpose of the transaction. It has also been so uncertain in its effects as to place a premium on litigation and a damper on valid business transactions. [p. 53]
>
> * * *
>
> Section 382. Special limitations on net operating loss carryovers
>
> * * *
>
> It provides that if the corporation has not continued to carry on a trade or business substantially the same as that conducted immediately before any change in the percentage ownership of the fair market value of the stock, the condition in subparagraph (C) is met. The change in percentage ownership refers to an increase which would be

(Footnote 5 continued on page A12)

382(a) seeks to prohibit is the stock purchase made "for the purpose of" using a carryover to offset profits of a business unrelated to that which caused the losses. The petitioner's sole business from 1931 until July 1, 1954, when it operated as the William Gerst Brewing Company, Inc., was the manufacture and distribution of beer. Prior to the abandonment of its brewery operations, petitioner had incurred substantial losses for 3 successive years. When the termination of the brewery business occurred, its principal assets consisted of the brewery equipment and the real property which it owned. The brewery equipment was sold, but Gerst was unable to arrange for an advantageous sale of its land and buildings. Consequently, it retained the real property and leased it. There is no doubt that renting property was not one of the business purposes for which Gerst was formed. Its corporate charter was never changed to reflect leasing as a business purpose, although technically under Tennessee law it had the power to rent its realty. But it had no intention of permanently doing so. The property was always for sale.

While it is true that Gerst incurred losses of $6,023.44 in 1955, and $5,112.50 in 1956 from leasing its property, these amounts were small by comparison with the previous losses of $302,069.48 incurred in the brewery operations. Respondent submits, and we agree, that the most reasonable and logical interpretation of the phrase "continued to carry on a trade or business substantially the same," as used in

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(Footnote 5 continued from page A11)

counted under subparagraphs (A) and (B) in determining whether the 50 percentage point increase has been reached. If, as a result of such an increase, the corporation shifts from one type of business to another, discontinues any except a minor portion of its business, changes its location, or otherwise fails to carry on substantially the same trade or business as was conducted before such an increase, then the condition in subparagraph (C) is met. [p. 285]

this statutory context, means the *active business,* viz., the manufacture and distribution of beer, which actually incurred the losses. See section 1.382(a)-1(h)(6), Income Tax Regs., and compare *Fawn Fashions, Inc.,* 41 T.C. 205, 214 (1963). Gerst Brewing Company had terminated its regular business activities and the stockholders rented the real property (1) as a step in the process of disposing of all the brewery assets and (2) as a means of minimizing its losses until an advantageous sale thereof could be arranged. Had it not owned its own real property it would have been completely inactive in 1957. To allow the petitioner the net operating losses merely because it happened to own the property in which it conducted the business for which it was created, but which had been terminated, would confer upon the petitioner benefits wholly beyond the spirt and intendment of section 382(a).

Petitioner argues that the primary, bona fide business purpose in the acquisition of its stock by Trippeer was to supply Euclid with a place to relocate its heavy equipment and machinery business at a time when it looked like Euclid's location would be taken for the construction of a new highway. Nevertheless, it is frankly admitted by petitioner that both Trippeer and Euclid knew about Gerst's prior net operating losses and that the tax advantage was an *inducement* to the purchase of Gerst's stock. It seems to us that the merger of Euclid into South Nashville Properties, Inc. (Gerst), was not necessary because the property acquired by Trippeer through its purchase of Gerst's stock could have been rented by Trippeer to Euclid. This at least casts some doubt on the genuineness of the alleged business purpose for the acquisition of Gerst's stock and the subsequent merger. Certainly the petitioner would be the beneficiary of an artificial tax situation.

There are several objective factors in this case which reflect that the business was in fact substantially changed in such a manner that the petitioner did not continue substantially the same trade or business. The property rentals were very insignificant in relation to the total income derived from the heavy equipment business. The pertinent figures are shown in our Findings of Fact. After the merger, rental income comprised about 1 percent of petitioner's gross income. Although the statute does not define the word "substantial," we think it is safe to say that Congress did not contemplate a ratio of 99 to 1 in favor of the added business.

The basic character of the business was also substantially changed by the addition of new employees, new customers, and the new product—heavy equipment and machinery. The charter of the corporation was likewise changed to correspond with that of the old Euclid-Tennessee, Inc. Other prime factors indicating a change in the business are the change in name and the change in location. The petitioner immediately took the name of the profitable corporation which was absorbed by it. And it continued to operate from the location of the profitable business and adopted this new address as its business address. These facts point to a substantial change in petitioner's business as contrasted with a continuation of substantially the same business.

We have carefully considered the case of *Goodwyn Crockery Co., supra,* which is principally relied upon by the petitioner, but find that it involved a factual situation so different from that present herein that we regard it as distinguishable.

In the *Goodwyn* case, the taxpayer. after the change in ownership, moved its principal office from Memphis, Tennessee, to Cairo, Illinois, and later to Scottsville, Ken-

tucky; experienced a turnover of employees; added a dry goods line to its durable household goods line, which constituted much of its business; began to operate as a retailer in addition to continuing to operate as a wholesaler; and integrated its operations with those of the acquiring corporation. We categorized the issue as requiring "a finding of absence or presence of substantial sameness of the trade or business." Reading the statute literally, we said that there could be some changes in the manner of conducting a trade or business without violating the requirement that the business in question remain "substantially the same." Thus, we found as a fact that, despite the many changes that occurred after the change in stock ownership, the *basic character* of Goodwyn's business remained unchanged, stating:

> It did business under the same name in the same area as a seller of general merchandise to the same type of customers.

In essence, this Court held in the *Goodwyn* case that what had taken place was not a change of business but an expansion from a wholesale seller of merchandise to an integrated wholesale-retail organization. The same merchandise was sold in the same area but in a different manner. That, of course, is far different from what we have here—an attempt to offset the losses of a brewery, which had not carried on its normal business activities for 2-1/2 years prior to the sale of its stock, against the profits of a heavy equipment business which was merged into it.

In *Goodwyn* the mere purchase of an additional line of business did not assure that any profits would ever be made to offset against its losses; whereas the merger of the heavy equipment business into the petitioner assured the petitioner of profits so that it could utilize the losses. In *Goodwyn* the addition of the new line of business was

directly related to its previously conducted business and there was no change in the name of the company; whereas in this case the heavy equipment business had no direct relation to either the brewery business or the leasing of property. Because of this fact the petitioner changed its name to that under which the heavy equipment business was conducted. Moreover, the leasing of property was insignificant in the overall operations of the petitioner after the merger. This was not true of the additional business added in *Goodwyn*. And, finally, in *Goodwyn* the additional line of business was not previously owned by the same controlling interests; whereas in the instant case Trippeer, a holding company, owned all the stock of the petitioner and the heavy equipment business which was merged into the petitioner.

After considering the factors previously discussed in the light of section 382(a), we have concluded that the *basic character* of the brewery business, which produced almost all of the losses, was so changed that it did not continue to carry on "substantially the same" business which generated the profits. Unlike the *Goodwyn* case, where a new line of business was added but the old business continued, we simply view the composite facts in this case as clearly demonstrating that the old business—the brewery operations and not the subsequent, insignificant leasing of its industrial property—has not continued substantially unchanged. Accordingly, we sustain respondent's disallowance of the net operating losses.

So holding, we find it unnecessary to decide, as respondent urges us to do, whether the principal purpose of the acquisition by Trippeer of Gerst's stock was to evade or avoid tax under the provisions of section 269(a). See *Federal Cement Tile Co.*, 40 T.C. 1028 (1963), on appeal (C.A. 7, February 17, 1964).

Decision will be entered for the respondent.